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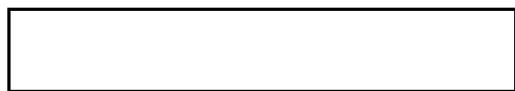


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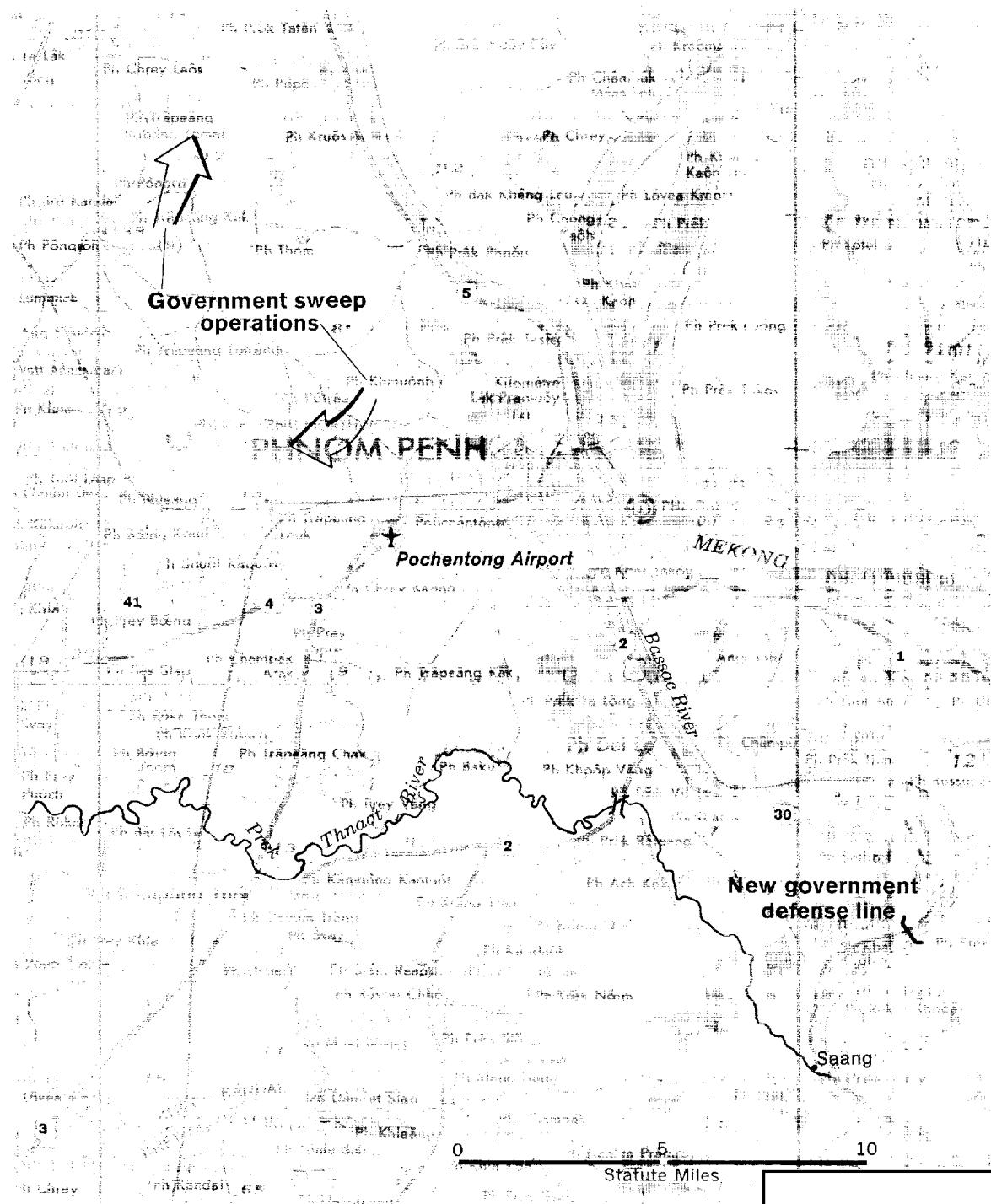
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Phnom Penh



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CAMBODIA: Fighting continues on several fronts within ten miles of Phnom Penh, but little ground has changed hands in the past few days.

Seven miles southwest of the capital, Cambodian Army units have failed to register substantial progress in clearing Khmer Communist forces from the area just to the west of Route 3. Government commanders in this sector are now attempting to push down the highway toward the Prek Thnaot River, the only natural barrier in the area. Farther east along the same river, army units guarding the Prek Ho bridge on Route 2--only five miles from the outskirts of Phnom Penh--so far have fended off daily insurgent probes. Other government troops, who pulled back from the town of Saang over the weekend, have formed a new defense line on the Bassac River ten miles downstream from the capital.

On the northern front, government units have mounted sweep operations from three to ten miles northwest of Phnom Penh's Pochentong Airport. In an effort to plug another gap in the capital's outlying defenses, several government battalions have taken up positions along a secondary road running north from Route 4. Insurgent shellings halted convoy traffic on this key highway for a brief period over the weekend. Phnom Penh's other major lines of communication--the Mekong River and Route 5 leading to the northwest--remain open to resupply convoys.

The mood among military and civilian leaders in Phnom Penh is mixed as the bombing deadline draws nearer. Some are making optimistic statements about the army's ability to hold on after 15 August; they believe there is a chance that limited US air support will continue after the deadline. Others, including several ranking field commanders, foresee a rapid decline in the army's performance after US air support halts.

CHINA: Peking released its first report on the 1973 harvest yesterday. The report says that the output of wheat, barley, lentils, and other summer-harvested crops was equivalent to the same harvest last year.

The subdued tone of the report suggests, however, that Peking is disappointed. The Chinese had hoped to compensate for the generally poor fall grain harvest last year by increasing the acreage of winter wheat in north China and by cultivating more winter grain crops and less rapeseed in the south. The wheat apparently fared much better than the other crops. Summer-harvested crops account for about 20 percent of annual grain production.

Unusually heavy and prolonged rainfall over most of south China adversely affected summer-harvested lentils as well as the more important early rice crop now being harvested. Preliminary reports indicate that output of early rice--which accounts for another 20 percent of China's annual production--may be no better than last year.

China's over-all grain supply position and import requirements over the next year will thus depend heavily on the important fall grain harvest. Changes in cropping patterns this year will result in an unusually late fall harvest, making the crop especially vulnerable to bad weather. [redacted]

EUROPEAN COMMUNITIES: A large group of less-developed nations has presented a surprisingly unified position against giving the EC tariff-free access to their markets--the so-called reverse preferences strongly opposed by the US. The African, Caribbean, and South Pacific states that are already EC associates or eligible for association gave their initial views on the subject at a conference in Brussels last week.

The EC itself has not thus far been able to agree on a position regarding these preferences. The conflict is primarily between France and the UK, with Paris insisting upon retaining the preferences and London lobbying against them. Industrial nations outside of the EC consider continuation or expansion of reverse preferences as a potential interference with their own trade with the developing world.

The Brussels meeting was only the first encounter in what could be a lengthy process of establishing new association arrangements. The unity displayed by the less-developed countries may break down as the actual negotiations--now scheduled to begin in mid-October--get under way. London's position has been strengthened, and the French delegate has admitted that the Brussels meeting seriously complicated the French stand on reverse preferences. Paris may now increase its pressures on the French-speaking African states to support its position.

A Dutch official has already commented that, if the EC does indeed drop its reverse preferences, the US should in turn promptly implement its scheme of generalized preferences for all lesser-developed countries.

EUROPEAN COMMUNITIES: Commission proposals to aid the development of backward regions in the community have been sent to the EC Council. Over the long term, establishment of a meaningful regional program could draw funds away from support of protectionist agricultural policies.

The commission recommends a three-year fund equivalent to \$2.9 billion. The EC budget would provide \$600 million in 1974, \$900 million in 1975, and \$1.2 billion in 1976; the European Educational Guidance and Guarantee Fund would add \$60 million annually. This is 20 percent less than the commissioner responsible for regional policy wanted, but still a large sum in terms of community practice thus far.

Even so, the fund may not be approved this year. The Nine committed themselves last fall to adopting a regional policy by the end of 1973, but it could well take longer to reconcile the considerable differences within the community. The British and Italians, who expect to gain the most, favor a large fund. The Germans support such efforts at integration, but their position as the largest potential contributor conflicts with their commitment to constrain government expenditures. The French have always been skeptical about heavy direct outlays for regional programs.

The British hope their gains from a community regional policy will offset the financial impact on London of the EC's Common Agricultural Policy. Many members of the UK Parliament protested last week when it was announced that the UK share of the supplemental EC budget for 1973 would be about \$80 million, which will be used to subsidize indirectly the sales outside the EC of surplus butter. By some estimates, \$80 million is as much or more than the UK could expect to net from a regional fund in its first year. The French vigorously reject the view that regional payments should be a compensation for expenditures on community agricultural programs.

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The French and British are also at odds about the proper relationship between regional policy and monetary union. The French are opposed to the idea that the UK and Italy will be able to benefit from a community regional fund while they remain outside the common currency float. The British, however, regard regional policy as an essential element of economic union and a prerequisite to a viable currency float and monetary union.

Other related issues, including the criteria for distributing the proceeds of the fund--between agricultural and industrial areas, for example--and the powers allowed the fund managers, will be hotly contested. The French and some other members are already angered by the efforts of the two British EC commissioners to incorporate rules of distribution favoring London. The commission, meanwhile, is seeking extensive powers for community bodies to approve regional projects and to allocate funds.

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ARGENTINA: Peron has still not named a vice presidential running mate, and recent reports cast doubt on earlier accounts that Radical Party leader Balbin would be selected. Speculation now has turned to possible choice of a new face, but so far there has been no indication that Peron has made a selection he can sell to his diverse movement. Governmental decision-making has been at a standstill, and there has been growing confusion over the direction of government policy. Peron reportedly plans to address the nation today or Wednesday, and he may then throw some light on his intentions.

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BRAZIL: Brasilia's goal to reduce inflation from 16 percent last year to 12 percent this year now looks as if it will not be attained. Wholesale price increases so far have been running at the same rate as last year, while retail prices are not far behind. Moreover, shortages of some food items, particularly meat, indicate some speculative withholding of supplies in expectation of higher prices.

Although the Medici government still publicly adheres to its anti-inflation goal, the achievement of the goal would require tighter price controls and export restrictions. As a move in that direction, exports of pig iron, soybeans, cotton, meat, and leather already have been limited.

Inflationary pressures stem from both domestic and external factors. Rising export prices for such products as soybeans and meat have diverted supplies from the local market, and poor weather conditions have reduced some important domestic food crops. At the same time, the money supply is growing faster, largely because heavy foreign capital receipts are making it more difficult than usual for the government to control excess liquidity. Foreign reserves grew by over \$1.3 billion during the first half of the year and now exceed \$5.5 billion.

FOR THE RECORD*

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European Space Developments: European aerospace ministers are meeting in Paris today to discuss whether Western Europe should take part in the US post-Apollo space program. Paris is threatening to block participation by the European Space Research Organization unless France gets all the financial support it needs for its own launcher program. France is upset over the UK's unwillingness to contribute even a token amount. [redacted]

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**These items were prepared by CIA without consultation with the Departments of State and Defense.*

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